



***Sunfire
Energy
Corporation***

**December 31, 2001
Annual Report**

CORPORATE PROFILE

Sunfire Energy Corporation is a Calgary based company engaged in the exploration, development and production of crude oil and natural gas.

The Company presently confines its exploration and development activities to a limited number of areas in Western Canada where it has developed expertise.

The Company's primary objective is to build shareholder value through the discovery, development and acquisition of crude oil and natural gas.

The Company is headquartered in Calgary and its common shares are listed on The TSX Venture Exchange under the trading symbol **SFE.A**.

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ANNUAL GENERAL MEETING

Shareholders are invited to attend the Annual General Meeting of the Corporation which will be held at the Hyatt Regency Downtown, 700 Centre Street South, Calgary, Alberta on June 12, 2002 at 3:00 p.m.

HIGHLIGHTS

FINANCIAL

FISCAL YEARS	12 months ended Dec. 31, 2001	12 months ended Dec. 31, 2000
	\$	\$
Revenue before royalties	11,359,187	10,911,794
Funds from Operations	5,508,119	6,143,442
Per Share-Basic *	0.46	0.58
Net income	1,234,155	2,416,326
Per Share-Basic *	0.102	0.23
Net Capital Expenditures	10,548,960	17,140,335
Shareholders' Equity	18,624,991	16,389,004
Number of Common Shares Outstanding at Year End	13,020,273	12,066,573

* Based upon the weighted average number of common shares outstanding during the fiscal years ended Dec. 2001 – 12,073,066; Dec. 2000 – 10,524,880.

OPERATIONS

FISCAL YEARS	12 months ended Dec. 31, 2001	12 months ended Dec. 31, 2000
Production		
Crude Oil / Liquids (Bbls/d)	81	70
Natural Gas (Mcf/d)	5,730	5,370
BOE/D	1,036	965
Reserves – Proven & Probable		
Crude Oil / Liquids (Mbls)	720	332
Natural Gas (Bcf)	37.1	29.4
Present Value of Reserves – Proven & 50% Probable (discounted at 12% before taxes)	\$41,860,000	\$48,126,000
Undeveloped Land Holdings		
Gross Acres	92,959	93,188
Net Acres	61,263	49,868

ABBREVIATIONS

Bbls	Barrels
Bbls/d	Barrels per day
Mbls	Thousand of barrels
Mcf	Thousand cubic feet
Mcf/d	Thousand cubic feet per day
MMcf	Million cubic feet
Bcf	Billion cubic feet
ARTC	Alberta Royalty Tax Credit
BOE	Barrels of Oil Equivalent
	6 Mcf = 1 Bbl

PRESIDENT'S MESSAGE

Sunfire's results for 2001 were mixed. The Company enjoyed high gas prices, increasing production volumes and a high level of cash flow in the first half of 2001. The second half of 2001, however, was a difficult period. Significantly lower gas prices and lower production volumes due to the Blackfoot shut-in severely decreased cash flow in the second half of 2001 which caused the Company to defer some capital projects.

Aside from the challenges experienced in the second half of the year, the Company's performance with respect to the capital program was strong. Highlights of the program are as follows:

- Proven and Established reserves increased significantly (22% and 27% respectively) compared to year-end 2000
- Finding and development costs were very low (\$5.37/BOE Proven, \$4.45/BOE Established)
- Attractive recycle ratios of 2.71 (Proven) and 3.27 (Established)
- Reserve life index increased to 8.4 (Proven) and 10.5 (Established) from 7.7 and 9.3 in 2000
- Replaced 2001 production by 712%
- Established Buick Creek, B.C. as a new core area

The first few months of 2002 were also challenging, but recently circumstances have been much more favourable. Production volumes at Blackfoot resumed in March and incremental volumes from Buick Creek have been placed onstream since year-end. Increasing volumes and relatively strong gas prices are expected to enhance future cash flow. Sunfire believes that the current environment presents an excellent opportunity to increase prospect inventory and have placed a high priority on creating and investing in more prospects. The Company's four core areas have a significant number of opportunities to enhance value and we intend to pursue those projects.

Sunfire also believes that the current environment presents an excellent time to acquire additional assets. The Company did not complete any acquisitions in 2001. For 2002, the Company has placed a high priority on pursuing acquisitions which are consistent with Corporate strategy. Acquisitions will be financed through a combination of available bank lines and issuing new equity. Sunfire continues to believe that the long-term fundamentals of natural gas look very positive and is positioning the Company accordingly.

The Company has a strong team of employees and Board of Directors. The Company added two new members to the Board, Jim Stanford and Nancy Smith. Sunfire is fortunate to be able to attract quality people like Jim and Nancy to our team.

In closing, the Company achieved some excellent results during the year and also faced some challenges in the second half of 2001. The future looks very promising and the Company is excited about the prospects for economic growth going forward.

I would like to thank all of Sunfire's stakeholders for their continued support.

On behalf of the Board of Directors



G.C. Merritt
President & C.E.O.

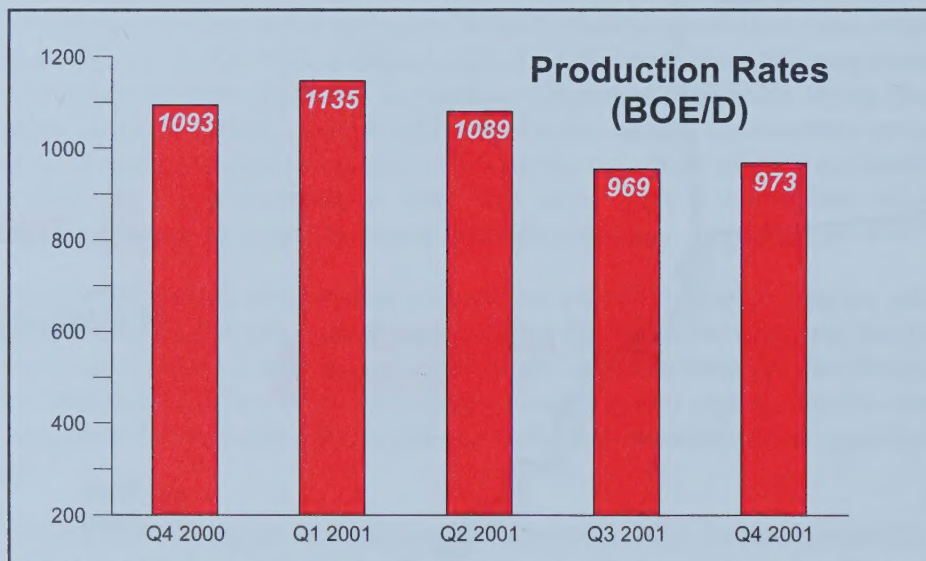


OPERATIONS REVIEW

PRODUCTION

Daily production volumes in 2001 increased by 7% over 2000. Gas volumes averaged 5.73 MMcf/d and oil production was 81 BOPD. Production at Blackfoot was suspended in July 2001 due to a lack of processing capacity at a gas plant operated by a third-party. Production resumed in March 2002 when the gas was re-routed to a different facility. A portion of the Thorhild gas production was lost due to a six-week turn-around at a non-operated compressor station. Production commenced at Buick Creek in August when the exploratory well, drilled in 2000, was placed onstream. Average production volumes during 2001 were:

	Oil& NGL (Bbls/d)	Gas (MMcf/d)	BOED
Thorhild	0	2.41	401
Lodgepole	58	2.12	412
Blackfoot	10	0.36	70
Buick Creek	2	0.10	18
Other	11	0.74	135
TOTAL	81	5.73	1036



DRILLING

Sunfire participated in the drilling of 23 wells of which 15 were successful resulting in a 65% success ratio. 78% of the wells were drilled in the Company's core areas. The results are as follows:

	Exploration		Development		Total	
	Gross	Net	Gross	Net	Gross	Net
Oil	-	-	-	-	-	-
Gas	8	4.56	7	4.67	15	9.23
Dry	8	6.37	-	-	8	6.37
TOTAL	16	10.93	7	4.67	23	15.60

LAND

Sunfire's land position increased in 2001. Net undeveloped acreage inventory increased by 23% over 2000. Additional land was acquired at crown sales, freehold acquisitions and earned by farmins. The Company's land position is summarized below:

	December 31, 2001		December 31, 2000	
	Gross Acres	Net Acres	Gross Acres	Net Acres
Developed	72,663	33,948	66,280	30,751
Undeveloped	92,959	61,263	93,188	49,868
	165,622	95,211	159,468	80,619

RESERVES

The Company's reserves were estimated at January 1, 2002, by the independent petroleum engineering firm of Martin & Brusset Associates of Calgary. The volumes and estimated present value of the Company's proved and probable reserves, as determined by Martin & Brusset, are shown in the following table. The values are forecast after the payment of operating expenses, capital costs and royalties, but prior to the payment of income taxes and indirect costs such as general and administrative expenses.

Petroleum and Natural Gas Reserves and Net Pre-Tax Cash Flows

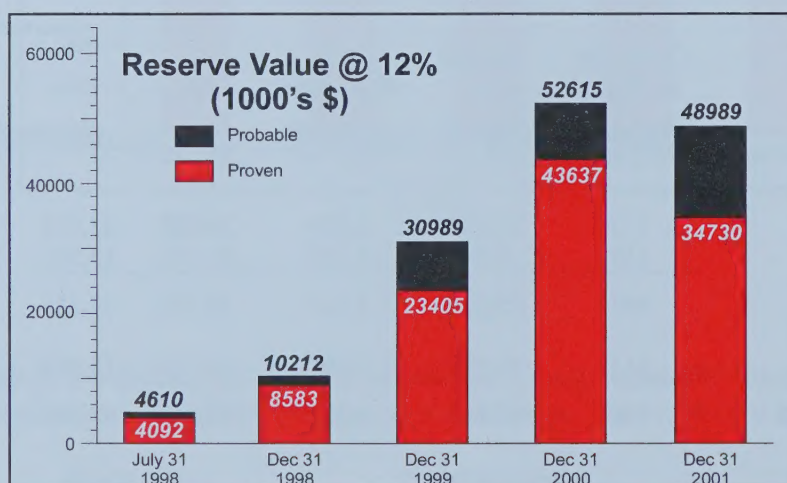
	Corporation's interest in reserves			Present worth of future net pre-tax cash flows			
	Crude Oil & NGL (Mbls)	Natural Gas (MMcf)	Bbl Equivalent (MBOE)	Discounted at			
				0%	10%	12%	15%
					(thousands of \$)		
Proved							
Producing	272	15,336	2,828	36,938	23,623	22,120	20,234
Non-producing	135	9,885	1,783	21,188	13,516	12,610	11,454
Total Proved	407	25,221	4,611	58,126	37,139	34,730	31,688
Probable Additional	313	11,929	2,301	34,219	15,865	14,259	12,353
Total including ARTC	720	37,150	6,912	92,345	53,004	48,989	44,041
Less risking of Probable Additional @ 50%	156	5,964	1,150	17,109	7,932	7,129	6,176
ESTABLISHED RESERVES	564	31,186	5,762	75,236	45,072	41,860	37,865

The Company does not have any reserves assigned to the Proved Undeveloped category. It is important to note that the Proved Non-Producing category includes reserves at Blackfoot that were onstream and categorized as Proved Producing prior to July, 2001 but were included in the Proved Non-Producing category because of the shut-in problem. The affected reserves represent 26% of the Proved Non-Producing category and have been returned to production in March, 2002.

RESERVE RECONCILIATION

	<u>Dec 31, 2000</u>	<u>Additions 2001</u>	<u>Production</u>	<u>Revisions</u>	<u>Dec 31, 2001</u>
Proved					
Oil (MSTB)	177	0	26.4	10.4	161
Gas (MCF)	21,188	10,750	2,093	(4,624)	25,221
NGL's (MSTB)	58	128	3.3	63.3	246
BOE (MBOE)	3,766	1,919	379	(697)	4,609
Probable					
Oil (MSTB)	155	87		(9)	233
Gas (MCF)	8,214	3,886		(171)	11,929
NGL's (MSTB)	20	47		13	80
BOE (MBOE)	1,544	782		(24)	2,301
TOTAL					
Oil (MSTB)	332	87	26.4	1.4	394
Gas (MCF)	29,402	14,636	2,093	(4,795)	37,150
NGL's (MSTB)	78	175	3.3	76.3	326
BOE (MBOE)	5,310	2,701	379	(721)	6,911

The revision to the Proved reserves are primarily due to one well watering-out at Thorhild and changing the reserve estimation methodology from volumetric estimates to material balance estimates at Blackfoot and Lodgepole.



The estimate of future net revenue is based on the following price forecast prepared by Martin & Brusset:

	Gas - Alberta Spot (\$CDN/MMBTU)	Oil – Edmonton Light Sweet (\$CDN/Bbl)
2002	3.70	30.70
2003	4.00	31.80
2004	4.00	31.30
2005	4.00	31.80
2006	4.00	32.20

The Company's Proven and Established reserve quantities increased by 22% and 27% respectively from year-end 2000. Sunfire replaced 712% of 2001 production with its exploration and development program.

CAPITAL EXPENDITURES

Capital expenditures totalled \$10,548,960 during the year. The expenditures were distributed as follows (\$):

	12 mos. Ending Dec. 31, 2001	12 mos. Ending Dec. 31, 2000
Land	1,126,004	566,439
Seismic	968,108	390,989
Drilling & Completions	5,716,924	4,545,314
Facilities	2,338,604	3,874,510
Total Exploration/Development	10,149,640	9,377,252
Property purchases	-	2,052,630
Corporate acquisitions	-	5,558,515
Other	399,320	151,938
TOTAL	10,548,960	17,140,335

The increase in Land and Seismic expenditures was a result of the Company's intent to increase its prospect inventory. Sunfire did not spend any capital on acquisitions in 2001.

MARKETING

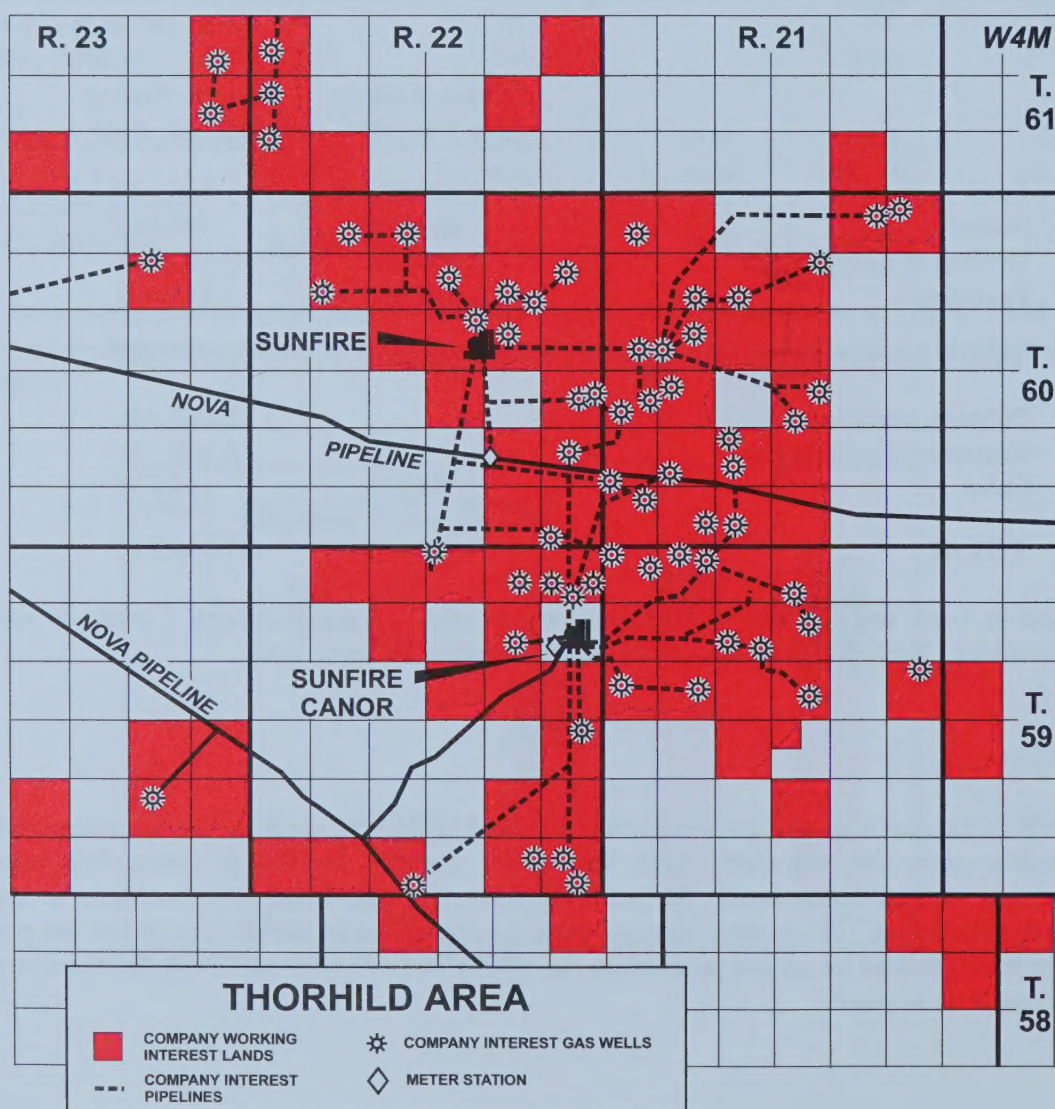
In 2001, 98% of Sunfire's natural gas production was sold to the spot market. Sunfire attempts to reduce the commodity price risk associated with the capital program by fixing commodity prices when appropriate. At various times during the year, the Company had fixed price contracts in place on a portion of gas production. The average price of those contracts was \$4.18/Mcf on 23% of gas production. The average price realized on all gas production was \$4.89/Mcf. At year-end 2001, the Company had no fixed price contracts in place.

MAJOR PROPERTIES

THORHILD, ALBERTA

Thorhild is located 45 miles North East of Edmonton. Sunfire has 50,000 net acres of land at Thorhild with an average working interest of 70%. Sweet gas is produced from several distinct geological horizons, including Wabamun, Glauconite (3), Sparky, Grand Rapids, Viking, Second White Specks and Edmonton Sand. Wells have a maximum depth of 3000 ft. Sunfire is the operator of the majority of its production and has interest in two gas plants in the area, one of which is Company operated. The Company has an extensive seismic database with 1500 km. of data in the area. More than 95% of the gas in Thorhild is sold to the spot market. Operating costs average \$4.50/BOE. Sunfire receives revenue from the transportation and compression of third party gas.

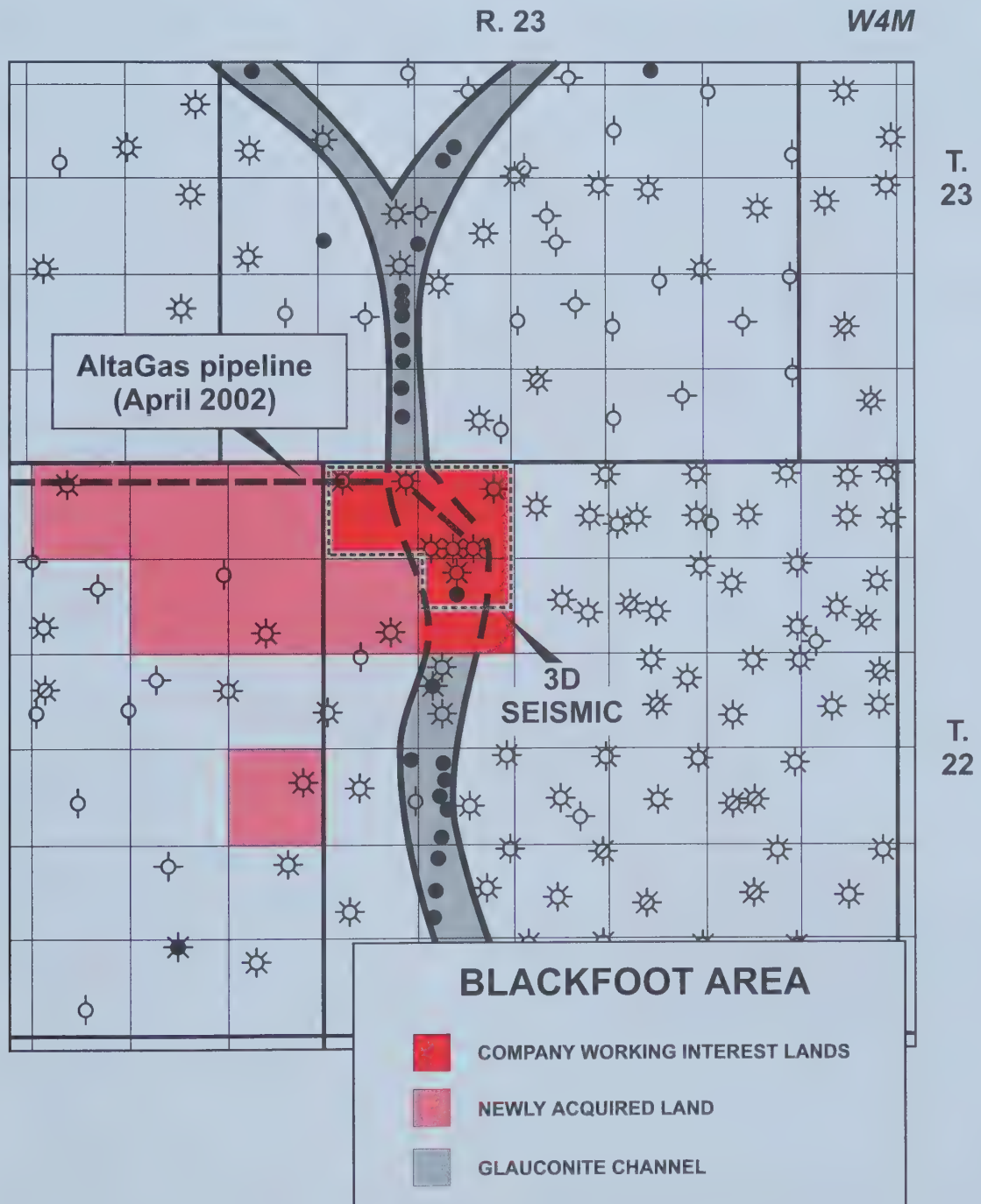
The Company drilled 7 wells in 2001 of which 6 were successful. 4 of the successful wells were placed onstream and the remaining 2 are scheduled to be onstream in 2002. The 2001 drilling program added 3.8 Bcf of Proven plus Probable reserves. Sunfire acquired an additional 4500 net acres of undeveloped land in 2001. Sunfire will continue to explore and develop the reserves via multi-well drilling programs and recompletion and optimization projects.



BLACKFOOT, ALBERTA

Sunfire has a 37.5% interest in 2400 net acres of land 30 miles East of Calgary. Production is obtained from the Glauconite, Bow Island and Belly River zones at depths up to 5700 ft. The Company uses 3D seismic to explore and develop reserves. Gas production from this property was interrupted from July, 2001 until March, 2002 due to restrictions at a gas plant owned by a third-party. The gas was re-routed to a system where gas can be produced on a permanent basis. Gas and oil production is sold to the spot market. Operating costs average \$5.45/BOE.

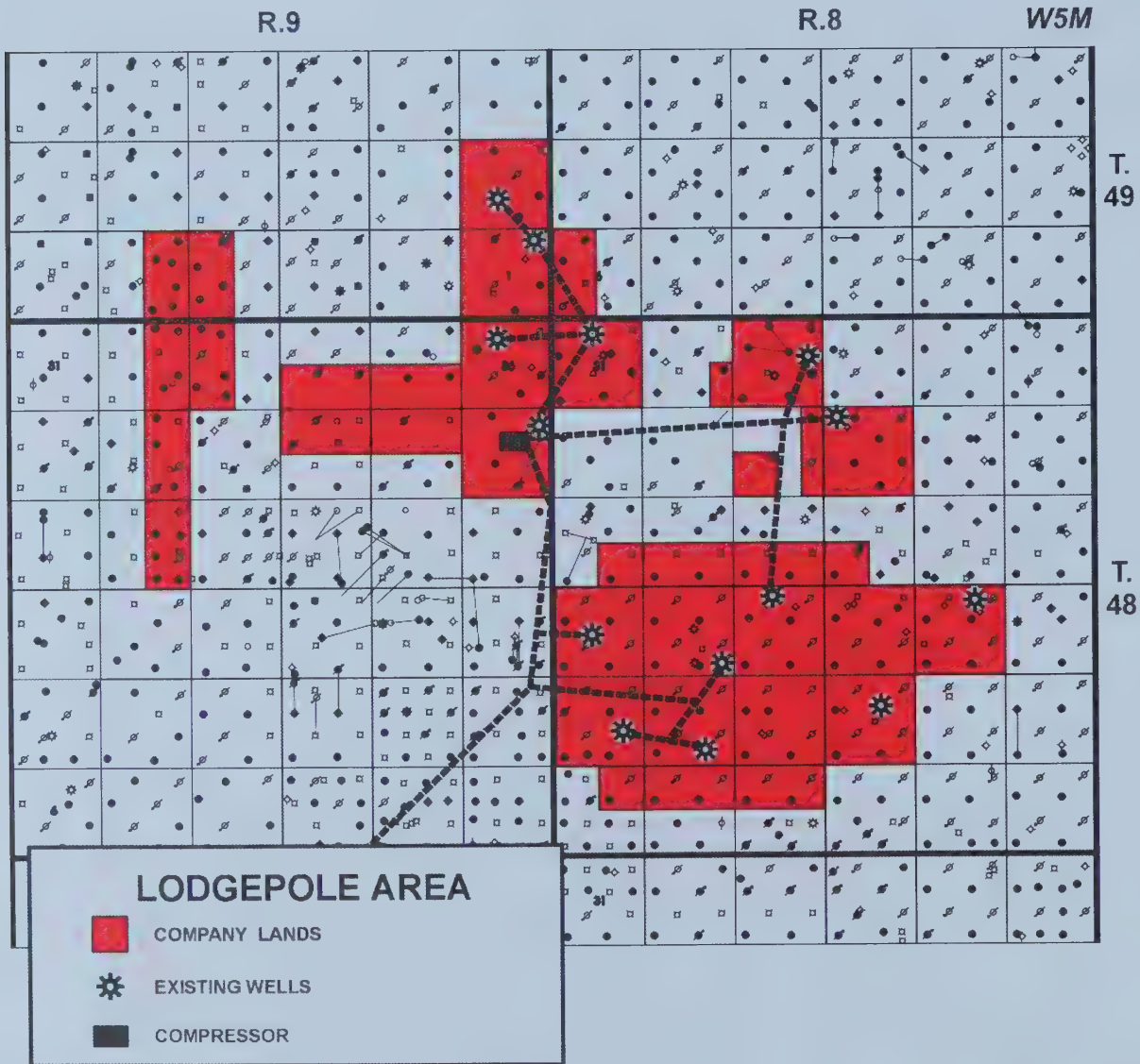
In 2001 the Company successfully drilled 1 well and recompleted 1 well in the Belly River zone. Sunfire expects to place the drilled well onstream in 2002 and the recompleted well was placed onstream in March, 2002. Sunfire acquired an additional 7 sections of land in 2001. The Company intends to develop the recently acquired lands with a multi-well program in 2002.



LODGEPOLE, ALBERTA

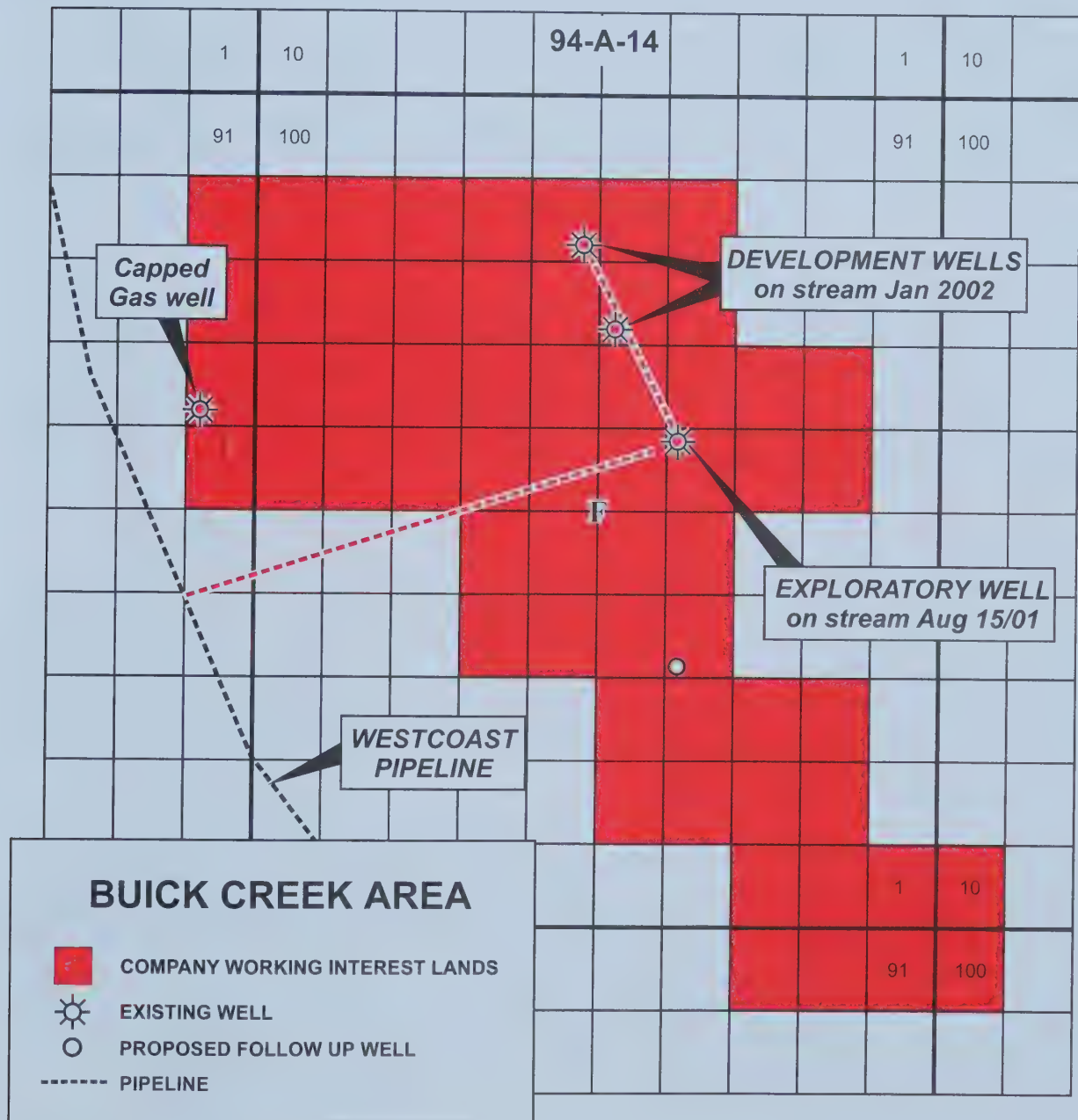
Sunfire has an average working interest of 70% in 11,000 net acres of land at Lodgepole which is located 60 miles South West of Edmonton. Sweet gas is produced from the Paskapoo and Edmonton sands within 1600 ft. of surface. Sunfire is the operator of the wells, gathering system and compressor station. The compressor delivers gas directly to the ATCO sales line and all gas from the area is sold to the spot market. The Company receives revenue from the transportation and compression of third party gas. Operating costs average \$4.40/BOE. Sunfire also has a 100% interest in 5 oilwells which produce from the Cardium formation.

The Company drilled 7 wells in 2001 of which 4 were successful. The successful wells are expected to be placed onstream in the second half of 2002. The drilling program added 1.0 Bcf of proven plus probable reserves.



BUICK CREEK, B.C.

Sunfire has a 40% working interest in 3600 net acres of land at Buick Creek, located approximately 30 miles North of Ft. St. John, B.C. Potential geological horizons include Slave Point, Debolt, Halfway, Nancy, Baldonell and Dunlevy. Current production comes from 3 wells completed in the Halfway zone. A total of 4 wells have been drilled on the lands. The fourth well was completed in the Nancy zone and is awaiting tie-in. The Baldonell zone was encountered in 3 of the 4 wells and we expect to exploit the Baldonell with horizontal wells – analogous to other pools in the area. Proved Producing reserves have been booked at 5.9 Bcf using volumetric reserve estimates. Sunfire owns equity in the infrastructure which ties directly into the Westcoast system. There are several follow-up locations on Company lands in the Baldonell, Halfway and Nancy zones.



MANAGEMENT'S DISCUSSION AND ANALYSIS

This management's discussion and analysis ("MD&A") of financial conditions and results of operations should be read in conjunction with the audited consolidated financial statements and MD&A for the years ended December 31, 2001 and 2000.

OPERATIONS

Sunfire drilled a total of 23 wells (15 net) and achieved a 65% success ratio. A total of \$10.3 MM was spent on the exploration/development program. No capital was spent on acquisitions in 2001. Sunfire established a fourth core area at Buick Creek, B.C. by drilling 3 successful wells in addition to the discovery well drilled in 2000. Production volumes averaged 1036 BOE/d (92% gas) which is 7.4% higher than last year. Production was reduced significantly when production at Blackfoot was shut-in from July to the end of the year. The gas was processed at a plant operated by a third party who decided to use all available capacity for its own volumes. Corporate production would have been approximately 15% higher had the shut-in not occurred. The shut-in had a significant effect on cash flow and earnings.

REVENUES

Revenue increased 3.5% compared to last year. Natural gas prices began the year very strong with spot prices averaging \$11.04 per Mcf in January, 2001. However, the underlying weakness in demand for natural gas experienced throughout North America in the last half of 2001 resulted in spot prices ending the year significantly lower with December averaging only \$3.53 per Mcf. Sunfire's natural gas prices averaged \$4.89 per Mcf in 2001 up 1.7% from \$4.81 per Mcf in 2000. The price of oil and liquids averaged \$36.05 per Bbl down 14% from \$41.97 per Bbl in 2000.

ROYALTIES

Royalties, net of the Alberta Royalty Tax Credit, increased from \$2.2 million in 2000 to \$2.6 million during 2001. Royalties, as a percentage of revenue, increased from 20% in 2000 to 23% in 2001 primarily due to fixed price gas contracts Sunfire had in place in the first quarter where royalties were paid according to the average market price and the fixed price contracts were lower than the market price.

OPERATING AND INTEREST COSTS

Average operating costs increased to \$5.45 per BOE for the year ended December 31, 2001 from \$4.30 per BOE for the same period in 2000. The recent production additions at Buick Creek and Blackfoot have higher unit operating costs than the remainder of the production base. General and administrative expenses increased 6% on a per BOE basis for the year ended December 31, 2001 to \$1.45 per BOE from \$1.36 per BOE in 2000. While interest expenses increased 15% in aggregate to \$581,405 due to higher average debt levels incurred in 2001, the interest rate decreased significantly due to a general decrease in borrowing costs and the negotiation of a new banking facility in July, 2001. The interest rate charged with the new facility is at prime whereas the previous facility charged prime plus ¾%.

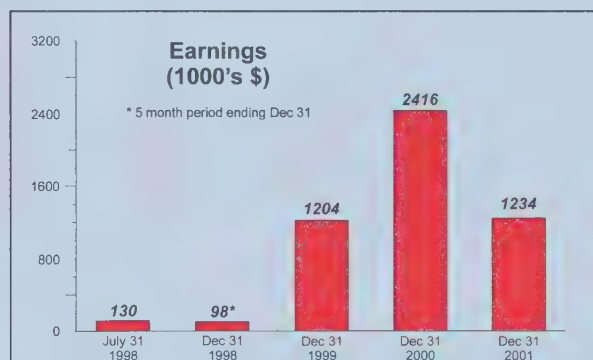
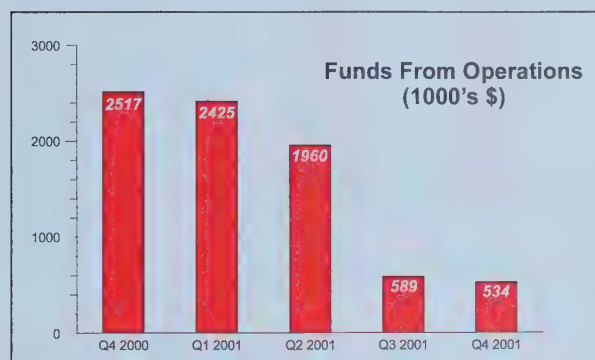
DEPLETION/AMORTIZATION

Depletion and amortization expenses increased to \$3.3 million in 2001 from \$2.4 million in the same period of 2000 due to Sunfire's larger asset base.

FUNDS FROM OPERATIONS AND NET INCOME

For the twelve months ended December 31, 2001, funds from operations decreased to \$5.5 million (\$0.46 per share) from \$6.1 million (\$0.58 per share) for the same period in 2000. The decrease was primarily caused by higher operating costs. Net income for 2001 also decreased to \$1.2 million (\$0.10 per share) from \$2.4 million (\$0.23 per share) for the same period in 2000. Net income was adversely affected by higher operating costs and higher depletion charges. Netbacks were \$14.57 per BOE. The components of Funds from Operations per BOE are as follows:

	TOTAL (\$)	\$ per BOE
Revenue	11,359,187	30.04
Royalties (net of ARTC)	2,596,719	6.87
Operating Costs	2,062,522	5.45
General & Administrative	548,422	1.45
Interest	581,405	1.54
Large Corporation Tax	62,000	0.16
NETBACK	5,508,119	14.57



LIQUIDITY AND CAPITAL RESOURCES

As at December 31, 2001, Sunfire had bank facilities with a revolving production loan of \$13 million and bank debt of \$9.75 million. Sunfire intends to limit exploration and development expenditures to cash flow in order to keep the bank debt constant throughout 2002. Any acquisitions completed in 2002 may be partially debt financed.

FINDING AND DEVELOPMENT COSTS

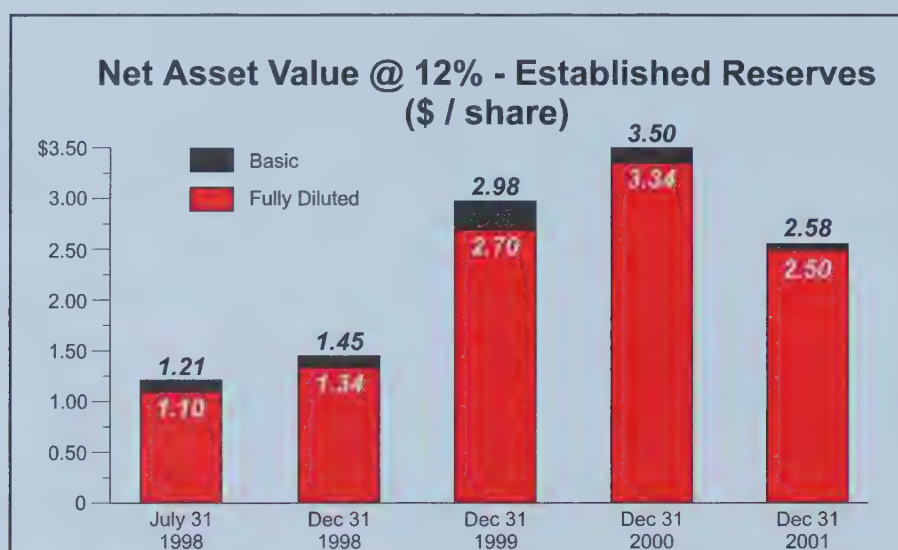
Reserve additions from the capital projects were 843 MBOE of Proven and 1,222 MBOE of Established reserves (Proven + 50% of Probable). 90% of the reserve additions were natural gas. The finding costs for the year and corresponding recycle ratios are as follows:

	F & D Cost (\$/BOE)	Recycle Ratio
Proven	5.37	2.71
Established	4.45	3.27
After Reserve Adjustments		
Proven	8.43	1.74
Established	6.44	2.30

NET ASSET VALUE

The Company's net asset value calculation is as follows (\$ MM):

	10% D.F.	12% D.F.	15% D.F.
Reserves – Established	45.1	41.9	37.9
Undeveloped Land @ \$65/acre	4.0	4.0	4.0
Debt plus Working Capital	(12.3)	(12.3)	(12.3)
	36.8	33.6	29.6
Per share – Basic (\$)	2.83	2.58	2.27
– Diluted (\$)	2.72	2.50	2.21



INCOME TAXES

The Company has adopted a new accounting standard for the recognition, measurement, presentation and disclosure of income taxes. This new standard requires the use of the liability method of tax allocation accounting, whereby the measurement of future tax assets or liabilities will be based on a balance sheet approach rather than the income statement approach under the deferral method. At Dec. 31, 2001 and Jan. 1, 2002, Sunfire had the following tax pool balances (\$):

	Dec. 31, 2001	Jan. 1, 2002
CEE	4,624,981	3,354,051
CDE	2,718,819	1,903,173
COGPE	6,572,454	5,915,209
CCA	8,308,234	6,514,424
Other	538,533	91,972
TOTAL	22,763,021	17,778,829

AUDITED FINANCIAL STATEMENTS
December 31, 2001

MANAGEMENT'S REPORT TO THE SHAREHOLDERS

The accompanying financial statements are the responsibility of management and have been prepared in accordance with accounting principles generally accepted in Canada.

Management acknowledges responsibility for the integrity of the financial statements and all other financial information in this annual report. Where appropriate, management has made informed judgments and estimates in accounting for transactions which affect the current accounting period but cannot be finalized with certainty until future periods. Company policies and procedures have been implemented to reasonably ensure that transactions are appropriately authorized, assets are safeguarded from loss and financial records are maintained. To further minimize risk, management maintains adequate systems of internal control.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and has appointed an Audit Committee. This committee, consisting of a majority of non-management directors, meets with management and external auditors to ensure that each group is properly discharging its responsibilities and to discuss internal control, accounting policies and financial reporting matters. The Audit Committee has reviewed the financial statements and has reported thereon to the Board of Directors. The Board of Directors has approved the financial statements for issuance to the Shareholders.



G.C. Merritt
 President



P.W. Goodman
 Secretary Treasurer

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of Sunfire Energy Corporation as at December 31, 2001 and 2000 and the consolidated statements of income and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2001 and 2000 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.



Chartered Accountants
 Calgary, Canada
 March 15, 2001

SUNFIRE ENERGY CORPORATION

Consolidated Balance Sheets

December 31, 2001 and 2000

	2001	2000
Assets		
Current assets:		
Cash	\$ 50,856	\$ 9,141
Accounts receivable	982,759	3,726,748
Prepaid expenses	204,541	119,968
	1,238,156	3,855,857
Petroleum and natural gas properties (note 3)	40,109,237	33,099,845
	<u>\$ 41,347,393</u>	<u>\$ 36,955,702</u>

Liabilities and Shareholders' Equity

Current liabilities:		
Accounts payable and accrued liabilities	\$ 2,330,751	\$ 5,398,141
Income taxes payable	26,547	50,000
Current portion of obligations under capital lease (note 5)	457,355	446,851
	2,814,653	5,894,992
Long-term debt (note 4)	9,752,368	5,644,940
Obligations under capital lease (note 5)	1,008,247	1,465,602
Provision for future site restoration	198,749	285,209
Future income taxes (note 7)	8,948,385	7,275,955
Shareholders' equity:		
Share capital (note 6)	12,158,230	11,051,398
Retained earnings	6,466,761	5,337,606
	18,624,991	16,389,004
	<u>\$ 41,347,393</u>	<u>\$ 36,955,702</u>

See accompanying notes to consolidated financial statements.

On behalf of the Board:



Geoffrey Merritt, Director



Douglas Mitchell, Chairman

SUNFIRE ENERGY CORPORATION

Consolidated Statements of Income and Retained Earnings

Years ended December 31, 2001 and 2000

	2001	2000
Revenue:		
Petroleum and natural gas sales	\$ 11,359,187	\$10,911,794
Less royalties and Alberta Royalty Tax Credit	(2,596,719)	(2,211,662)
	8,702,104	8,700,132
Interest and other income	60,364	—
	8,762,468	8,700,132
Expenses:		
Production	2,062,522	1,518,677
General and administration	548,422	481,695
Interest on long-term debt	581,405	506,318
Depletion and amortization	3,285,402	2,368,354
Site restoration	167,706	185,750
	6,645,457	5,060,794
Income before income taxes	2,117,011	3,639,338
Provision for income and other taxes:		
Future income taxes (note 7)	820,856	1,173,012
Large corporations tax	62,000	50,000
	882,856	1,223,012
Net income	1,234,155	2,416,326
Retained earnings, beginning of year	5,337,606	2,921,280
Repurchase of common shares (note 6(b))	(105,000)	—
Retained earnings, end of year	\$ 6,466,761	\$ 5,337,606
Earnings per share:		
Basic	\$ 0.10	\$ 0.23
Diluted	\$ 0.10	\$ 0.23

See accompanying notes to consolidated financial statements.

SUNFIRE ENERGY CORPORATION

Consolidated Statements of Cash Flows

Years ended December 31, 2001 and 2000

	2001	2000
Cash provided by (used in):		
Operations:		
Net income	\$ 1,234,155	\$ 2,416,326
Items not involving cash:		
Depletion and amortization	3,285,402	2,368,354
Future income taxes	820,856	1,173,012
Site restoration provision	167,706	185,750
Funds from operations	5,508,119	6,143,442
Change in non-cash operating working capital	(431,427)	(1,521,229)
	5,076,692	4,622,213
Financing:		
Common shares issued	2,029,000	2,732,100
Increase in long-term debt	4,107,428	5,644,940
Obligation under capital lease	—	1,994,872
Principal repayment under capital lease obligation	(446,851)	(82,419)
Shares repurchased	(175,594)	—
	5,513,983	10,289,493
Investments:		
Petroleum and natural gas properties	(10,294,794)	(11,530,936)
Acquisition of Braegan Energy Ltd. (note 2)	—	(5,145,905)
Acquisition of 725620 Alberta Ltd. (note 2)	—	(412,610)
Site restoration costs	(254,166)	(50,884)
	(10,548,960)	(17,140,335)
Increase (decrease) in cash	41,715	(2,228,629)
Cash, beginning of year	9,141	2,237,770
Cash, end of year	\$ 50,856	\$ 9,141
Funds from operations per share:		
Basic	\$ 0.46	\$ 0.58
Diluted	\$ 0.44	\$ 0.57

During 2001, the Corporation paid \$580,705 (2000 - \$489,841) of interest on long-term debt and cash income taxes of \$35,453 (2000 - \$nil).

See accompanying notes to consolidated financial statements.

The Company is engaged in the exploration for and production of petroleum and natural gas in Alberta.

1. Significant accounting policies:

The consolidated financial statements of the Company have been prepared by management in accordance with Canadian generally accepted accounting principles. The consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are wholly-owned. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The financial statements have, in management's opinion, been properly prepared using careful judgment with reasonable limits of materiality and within the framework of the significant policies summarized below:

(a) Petroleum and natural gas properties:

The Company follows the full cost method of accounting for petroleum and natural gas operations, whereby all costs of exploring for and developing petroleum and natural gas reserves are capitalized. Such costs include land acquisition costs, cost of drilling both productive and non-productive wells, related plant and production equipment costs, and geological and geophysical expenses and overhead directly related to these activities.

Capitalized costs, excluding costs relating to unproven properties, are depleted and depreciated using the unit-of-production method based on estimated gross proven reserves of petroleum and natural gas before royalties as determined by independent petroleum engineers. For purposes of the depletion and depreciation calculation, natural gas reserves and production are converted to equivalent volumes of crude oil based on relative energy content.

The costs of acquiring and evaluating unproved properties are excluded from depletion calculations. These properties are assessed periodically to ascertain whether impairment has occurred. When proved reserves are assigned or the property is considered to be impaired, the cost of the property or the amount of impairment is added to costs subject to depletion.

The Company applies a "ceiling test" to capitalized costs to ensure that the net costs capitalized do not exceed the estimated future net revenues from the production of its proven reserves, plus the cost of undeveloped lands, less impairment. Future net revenues are calculated at year end prices and include an allowance for estimated future general and administrative expenses, interest expense and income taxes.

Proceeds from the sale of petroleum and natural gas properties are applied against capital costs, with no gain or loss recognized, unless such a sale would significantly alter the rate of depletion and depreciation. The amounts recorded for depletion, depreciation and amortization of petroleum and natural gas properties and equipment and the provision for future site restoration and abandonment costs are based on estimates. The ceiling test is based on estimates of proved reserves, production rates, petroleum and natural gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

1. Significant accounting policies (continued):**(b) Interest in joint ventures:**

Substantially all of the Company's petroleum and natural gas exploration and development activities are conducted jointly with others and, accordingly, the financial statements reflect only the Company's proportionate interest in such activities.

(c) Future site restoration and abandonment costs:

Estimated site restoration and abandonment costs are provided for over the life of the estimated proven reserves on a unit-of-production basis. Costs are estimated each year by management in consultation with the Company's engineers based on current regulations, costs, technology and industry standards. The period charge is expensed and actual site restoration and abandonment expenditures are charged to the accumulated provision account as incurred.

(d) Per share amounts:

The Corporation has retroactively adopted the new standards for the computation, presentation and disclosure of diluted per share amounts effective January 1, 2001. Under the new standard, the treasury stock method is used instead of the imputed earnings method to determine the dilutive effect of stock options and other dilutive instruments. Under the treasury stock method, only dilutive instruments, where the market price exceeds the issue price, impact the diluted calculations. In computing diluted earnings and cash flow from operations per share, 380,533 net shares were added to the weighted average number of common shares outstanding during the year ended December 31, 2001 (2000 – 297,990) for dilutive effect of employee stock options. No adjustments were required to reported earnings or cash flow from operations in computing diluted per share amounts. As a result of this change in accounting policy, diluted earnings per share for 2000 increased by \$0.01 and diluted cash flow per share for 2000 increased by \$0.02. A total of 390,000 (2000 – nil) options were excluded from the diluted calculations, as they are not dilutive.

(e) Flow-through shares:

The resource expenditure deductions for income tax purposes related to exploratory and development activities funded by flow-through share arrangements are renounced to investors in accordance with tax legislation. Share capital is reduced and a future income tax liability is recorded for the estimated cost of the renounced tax deductions when the shares are issued.

(f) Financial instruments:

The Company periodically enters into derivative instrument contracts to manage exposure related to petroleum and natural gas prices. Settlement amounts on commodity and foreign currency hedge contracts are recognized in earnings as the related production revenues are recorded (see note 8).

The carrying value of current assets and current liabilities approximate their fair value due to the relatively short period to maturity of the instruments.

1. Significant accounting policies (continued):

(g) Stock option plan:

The Company has a stock option plan which is described in note 6. When stock options are granted, no compensation expense is recorded. Consideration received on the exercise of the stock option is credited to share capital.

(h) Income taxes:

Effective January 1, 2000, the Company retroactively adopted the liability method of accounting for future income taxes. Under the liability method, future income tax assets and liabilities are determined based on "temporary differences" (differences between the accounting basis and the tax basis of the assets and liabilities), and are measured using the currently enacted, or substantively enacted, tax rates and laws expected to apply when these differences reverse. Income tax expense or benefit is the sum of the Company's provision for current income taxes and difference between the opening and ending balances of the future income tax assets and liabilities.

2. Acquisitions:

(a) Acquisition of Braegan Energy Ltd.:

On March 14, 2000, the Company acquired all the outstanding shares of Braegan Energy Ltd. The acquisition was accounted for using the purchase method with the purchase price allocated as follows:

Current assets	\$ 523,442
Petroleum and natural gas properties	9,337,835
Current liabilities	(2,145,887)
Future income tax liability	(2,533,165)
Site restoration	(36,320)
Cash consideration for net assets acquired	\$ 5,145,905

(b) Acquisition of 725620 Alberta Ltd.:

On June 23, 2000, the Company acquired all the outstanding shares of 725620 Alberta Ltd. The acquisition was accounted for using the purchase method with the purchase price allocated as follows:

Current assets	\$ 90,196
Current liabilities	(130,943)
Petroleum and natural gas properties	719,508
Future income tax liability	(266,151)
Cash consideration for net assets acquired	\$ 412,610

3. Petroleum and natural gas properties:

	2001	2000
Petroleum and natural gas properties	\$ 50,100,233	\$ 39,805,439
Less accumulated depletion and depreciation	(9,990,996)	(6,705,594)
	\$ 40,109,237	\$ 33,099,845

A ceiling test was conducted at December 31, 2001 using average prices for the year. If the ceiling test had been performed using Company year-end prices of \$3.47/mcf for gas and \$32.38/bbl for oil, a write-down of approximately \$2.4 million, net of tax, would have been required.

At December 31, 2001, petroleum and natural gas properties include \$1,994,872 (2000 - \$1,994,872) of assets under capital lease.

Unproved properties with a cost of approximately \$1,647,989 (2000 - \$1,158,503) included in petroleum and natural gas properties have not been subject to depletion.

At December 31, 2001, the estimated future site restoration costs to be accrued over the remaining proved reserves totaled approximately \$1,503,000 (2000 - \$1,708,000).

4. Long-term debt:

The Company has a \$13 million extendible revolving production loan facility with a Canadian chartered bank with interest at the bank's prime interest rate. In addition, the Company has a \$1 million U.S. swap facility. The production loan is secured by a \$25 million first floating charge debenture. The credit facility is subject to periodic review. If the facility were not extended, it would convert into a two-year term facility repayable in equal quarterly installments.

5. Obligations under capital lease:

Future lease commitments relating to the 2000 acquisition of compressors, excluding interest at 8.125%, payable by the Company are as follows:

2002	\$ 457,355
2003	353,919
2004	654,328
Total lease payments	1,465,602
Current portion of obligation under capital lease	457,355
	\$ 1,008,247

Interest of \$138,996 relating to capital lease obligations has been included in interest on long-term debt expense.

6. Share capital:

(a) Authorized:

- Unlimited number of Class A voting common shares
- Unlimited number of Class B non-voting common shares
- Unlimited number of Class C, D and E preferred shares

(b) Issued:

Class A common shares	Number of shares	Amount
Balance, December 31, 1999	10,102,573	\$ 8,676,095
Issuance of common shares on exercise of stock options	50,000	35,000
Issuance of common shares on exercise of warrants	1,500,000	1,600,000
Issuance of flow-through common shares	414,000	1,097,100
Tax effect on flow-through shares	—	(489,307)
Change in accounting policy (note 9)	—	132,510
Balance, December 31, 2000	12,066,573	11,051,398
Issuance of shares on exercise of stock options	30,000	30,000
Issuance of flow-through common shares	1,000,000	2,000,000
Tax effect on flow-through common shares	—	(852,000)
Repurchase of shares	(76,300)	(70,594)
Share issue costs (net of tax effect of \$426)	—	(574)
Balance, December 31, 2001	13,020,273	\$ 12,158,230

Pursuant to a normal course issuer bid, the Company purchased 76,300 of its issued and outstanding common shares for a total cost of \$175,594. The excess of the cost over the assigned value of the shares of \$105,000 was allocated to retained earnings.

(c) Flow-through shares:

On December 13, 2001, the Company completed a private placement of 1,000,000 flow-through Class A common shares at \$2.00 per share.

On December 28, 2000, the Company completed the private placement of 414,000 flow-through Class A common shares at \$2.65 per share.

Share capital was reduced and future income taxes were increased by the estimated amount of the tax benefits renounced.

At December 31, 2001, the Company is committed to expend and renounce \$2,000,000 in qualified expenditures.

Years ended December 31, 2001 and 2000

6. Share capital (continued):

(d) Stock options:

Under an incentive stock option plan, the Company has granted 1,125,000 stock options to purchase common shares of the Company to directors and employees of the Company. The following table summarizes the changes in the Company's stock option plan:

	2001		2000	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Stock options outstanding, beginning of year	900,000	\$ 1.15	550,000	\$ 0.95
Granted	255,000	2.45	400,000	1.38
Exercised	(30,000)	1.00	(50,000)	0.70
Stock options outstanding, end of year	1,125,000	\$ 1.45	900,000	\$ 1.15
Stock options exercisable, end of year	796,666	\$ 1.13	790,000	\$ 1.11

The following table summarizes information about stock options outstanding and exercisable as at December 31, 2000:

Range of exercise prices	Options outstanding			Options exercisable	
	Number outstanding	Weighted average remaining contractual life	Weighted average exercise price	Number exercisable	Weighted average exercise price
\$ 0.70 – 1.10	445,000	1.6 years	\$ 0.92	445,000	\$ 0.92
1.25 – 1.50	390,000	2.2 years	1.36	323,333	1.36
1.90 – 2.05	35,000	3.0 years	1.94	28,333	1.92
2.25 – 2.50	255,000	4.5 years	2.45	—	—
\$ 0.70 – 2.50	1,125,000	2.5 years	\$ 1.45	796,666	\$ 1.13

(e) Warrants:

In connection with a private placement undertaken by the Company on April 30, 1998, the Company issued 500,000 warrants. Each warrant entitled the holder to purchase one Class A common share at \$0.70 per share on or before April 30, 2000. In connection with a private placement undertaken by the Company on December 31, 1998, the Company issued 1,000,000 warrants. Each warrant entitled the holder to purchase one Class A common share at \$1.25 per share on or before December 18, 2000. Both groups of warrants were exercised during 2000.

Years ended December 31, 2001 and 2000

7. Income taxes:

- (a) The provision for income taxes differs from the amount obtained by applying the combined Federal and Provincial income tax rate of 42.6% to income before income taxes. The difference relates to the following items:

	2001	2000
Income tax rate	42.6%	44.6%
Expected income tax provision	\$ 901,847	\$ 1,623,145
Non-deductible crown charges	914,083	846,115
Alberta Royalty Tax Credit	(193,899)	(187,920)
Resource allowance	(740,487)	(895,093)
Effect of change in tax rate	(325,627)	—
Effect of tax reassessment	272,523	—
Other	(7,584)	(213,235)
	\$ 820,856	\$ 1,173,012

The components of the future income tax liability at December 31, 2001 are as follows:

	2001	2000
Future income tax assets:		
Share issue costs and other tax assets	\$ 38,826	\$ 45,234
Future site restoration	63,500	95,402
	\$ 102,326	\$ 140,636
Future income tax liabilities:		
Petroleum and natural gas properties	\$ 9,050,711	\$ 7,416,591
Net future income tax liability	\$ 8,948,385	\$ 7,275,955

- (b) At December 31, 2001, the Company has approximately \$20 million of resource and other unused income tax pools available for deduction against future taxable income.

8. Financial instruments:**(a) Credit risk:**

A substantial portion of the Company's accounts receivable are with customers and joint venture partners in the petroleum and natural gas industry and are subject to normal industry credit risks. Purchasers of the Company's natural gas, crude oil and natural gas liquids are subject to an internal credit review to minimize the risk of non-payment.

(b) Commodity risk:

The Company seeks to reduce its exposure to commodity price risk in its business through the use of physical product arrangements, futures, and options.

(c) Fair value of financial instruments:

The carrying amounts of financial instruments included in the balance sheet, other than long-term debt, approximate their fair value due to their short-term maturity. The long-term debt carrying value approximates fair value due to the cost of borrowing being at a floating rate.

9. Change in accounting policy:

Effective January 1, 2000, the Company changed its method of accounting for taxes from the deferral method to the liability method described in note 1 and has applied this change retroactively without restating prior periods. At January 1, 2000, the future income tax liability was increased by \$1,574,820, property, plant and equipment was increased by \$1,707,330 and share capital was increased by \$132,510. These adjustments were a result of recognizing the future income tax costs of renouncing deductions to flow-through share subscribers.

NOTES

NOTES

CORPORATE INFORMATION

DIRECTORS

Geoffrey C. Merritt
Calgary, Alberta
President of the Corporation

Roderick Campbell *(1,3)*
Calgary, Alberta
Business Consultant

Douglas H. Mitchell (Chairman) *(2,3)*
Calgary, Alberta
Co-Chairman and Managing Partner
of Borden Ladner Gervais LLP

William R. Stedman *(1,2)*
Calgary, Alberta
Chairman and CEO
of ENTX Capital Corporation

James M. Stanford *(3)*
Calgary, Alberta
President of Stanford Resource Management

Nancy Smith *(1)*
Calgary, Alberta
Senior Vice President of Finance and
Administration of ARC Financial Corporation

(1) Member of Audit Committee

(2) Member of Compensation Committee

(3) Member of Corporate Governance Committee

AUDITORS

KPMG LLP
Calgary, Alberta

EVALUATION ENGINEERS

Martin & Brusset Associates
Calgary, Alberta

LEGAL COUNSEL

Borden Ladner Gervais LLP
Calgary, Alberta

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Trading Symbol SFE.A

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